

MINUTES

BOARD OF TRUSTEES OF THE PUBLIC EMPLOYEES' RETIREMENT FUND 143 West Market Street, Suite 500 Indianapolis, IN 46204

February 8, 2002

Trustees Present

Jonathan Birge, Chair
Richard Doermer, Vice Chair
Teresa Ghilarducci (by telephone)
Steven Miller
Nancy Turner

Others Present

Mike Gery, Executive Assistant to the Governor
Diana Hamilton, Special Liaison to the Governor for Public Finance
Richard Boggs, Burnley Associates
Stephanie Braming, William M. Mercer Investment Consulting
Micah Fannin, William M. Mercer Investment Consulting
Mary Beth Braitman, Ice Miller
Eric Swank, Ice Miller
Doug Todd, McCready & Keene, Inc.
Karen Franklin, National City Bank
William Crawford, UAW/AFT Benefits Rep Local 9212
E. William Butler, PERF Executive Director
Patricia Gerrick, PERF Chief Investment Officer
Tim Legesse, PERF Investment Analyst
Joseph Duncan, PERF Investment Analyst
Tommie Wilson, PERF Investment Assistant
Krena Patel, PERF Intern
Diann Clift, PERF MIS Director
Ed Gohmann, PERF Legal Counsel
Doug Mills, PERF Chief Financial Officer
Jim Osborn, PERF Project Director
Kevin Scott, PERF Director of Benefits Administration
Kenneth Stoughton, PERF Director of Human Resources
Lynda Duncan, Minute Writer

ITEMS MAILED TO THE BOARD PRIOR TO MEETING

- A. Agenda of February 8, 2002 Meeting
- B. Minutes:
 - ❑ January 16, 2002 Board of Trustees Meeting
 - ❑ January 16, 2002 Benefits Administration Committee Meeting
 - ❑ October 5, 2001 and November 28, 2001 Investment Committee Meeting
 - ❑ Reports, Summaries, Memorandums and/or Letters Concerning:
 - ❑ Proposed Resolution No. 01-03 of the Board of Trustees, PERF
 - ❑ Compliance Reports, Burnley Associates
 - ❑ Quarterly Performance Update, William M. Mercer
 - ❑ Alternative Investment Procedures
 - ❑ Schedule of Administrative Expenses and Investment Fees

A quorum being present, the meeting was called to order.

EXECUTIVE SESSION

The Board met in Executive Session under IC 5-14-1.5-6.1(b)(2) to discuss a litigation issue.

REGULAR SESSION

1. MINUTES APPROVAL

MOTION duly made and carried to approve the Minutes of the January 16, 2002 meeting of the Board of Trustees.

Proposed by: Steven Miller
Seconded by: Nancy Turner
Votes: 5 for, 0 against, 0 abstentions

2. DISCLOSURES

Mr. Doermer – Bank One stock ownership.

3. LEGAL ISSUES

- Proposed Resolution No. 01-03. This specifies that a quorum of the Board of Trustees must be physically present at a meeting of the Board in which any other Board member who is not physically present participates by teleconferencing or video conferencing. This does not apply to Committee meetings. Other quasi agencies that may use teleconferencing or videoconferencing have already adopted this provision. This is in compliance with IC 5-10.2-2-16, which was enacted in 2001 to allow members of the Board of Trustees to participate in Board meetings by any means of

communication that permits other Board members and members of the public who are physically present at the meeting to simultaneously communicate with each other.

MOTION duly made and carried to adopt resolution No. 01-03.

Proposed by: Steven Miller
Seconded by: Nancy Turner
Votes: 5 for, 0 against, 0 abstentions

4. LEGISLATIVE UPDATE. Mary Beth Braitman of Ice Miller provided a Bill Status Report. This gave an update on the progress of PERF-related bills which had successfully passed through the house of origin in the General Assembly.
- HB 1004. Reduces property taxes; eliminates gross income tax, sales and other tax. During the original governor's proposal for this bill, it included an additional \$30 Million for Police and Fire Fighter pension relief. This was stripped out in the House of Ways and Means Committee. As proposed by the Governor, and as it had left the Ways and Means Committee, it did not contain anything concerning venture capital or "alternative investments" by PERF. The House Republican version of a venture capital initiative had been attached to this bill in an attempt to get the requisite votes. This contained the 20% set-aside for Indiana PERF alternative investments. It has a long way to go through the Senate, and some Senators do not view venture capital to be a very important part of the bill.
 - SB 0380. Venture capital tax credit. This does not affect PERF. It provides that a taxpayer that provides qualified investment capital to a qualified Indiana business is entitled to a credit against the taxpayers state tax liability equal to 20% of the amount of the investment. This is being backed by the Indiana Chamber of Commerce and has broad sponsorship in the Senate.
 - HB1065. Annual PERF cost-of-living adjustment. This establishes an annual cost-of-living adjustment for members of PERF (or their survivors or beneficiaries) subject to certain conditions. PERF's COLA is funded under actuarial assumptions. This is the furthest that an annual COLA bill (as opposed to an ad hoc COLA) has reached in years. It also includes a one-year ad hoc Teachers Retirement Fund (TRF) COLA. TRF has not funded a COLA, and there is no assumption in their new fund. Their COLA is still being treated on an ad hoc basis. This bill has strong support, achieving 91 to 1 votes coming out of the House.
 - HB 1081. Line of duty health care expenses for police and firefighters. This requires that a police or fire special service district, a town, a township, a fire protection district, or a provider unit fire protection territories pay the medical and hospital care expenses for a police officer or firefighter who is injured or

contracts an illness in the line of duty. This bill could help some of PERF's members by providing for medical and hospital expenses for police officers and firefighters injured in the line of duty. It came out of the House with strong support. It would not affect PERF, except that some PERF members would receive this coverage.

- HB1245. Withholding from pensions for child support. This provides that benefit payments from certain pension funds are subject to withholding for child support. If passed, this would entail an administrative burden for PERF, because it would probably necessitate a dedicated staff to deal solely with this issue. The key group urging passage of this bill is the prosecutors. Senator Harrison has signed on as a sponsor. The intention is to collect as much of the child support directly from the source pay, and hence the initiatives to capture this directly from the employers and different accounts. It could involve hundreds of different payments being made to different entities (individual, prosecutors, etc.). PERF's current benefit processes are based on paying one person. This would generate multiple pay orders.
- HB1356. Various tax matters. This specifies circumstances under which a sales tax return does not need to be filed each month. This is a critical bill for PERF in that it includes a provision to update references in state law to the federal Internal Revenue Code to refer to the version of the Internal Revenue Code as amended through January 1, 2002. If this bill were not passed, all of the tax benefits advantages in the 2001 federal tax legislation would not be reflected in the Indiana Code. The Indiana code ties in to the federal adjusted gross income as determined under the 2001 Internal Revenue Code and not to 2002 federal code. This is a traditional bill to update the state law reference to the Internal Revenue Code. If this bill does not pass, it will create a disconnect between Federal and Indiana tax allowances.
- SB58. Magistrates' Pensions. This would move Magistrates to the Judges 1985 benefit system. It would also allow them to purchase their prior service credit. This will entail extra work for PERF in counseling regarding the changeover and in processing prior service credit.
- SB59. PERF and TRF administrative issues. This bill would permit the pooling of assets between PERF and TRF and other entities for investment purposes. It clarifies that PERF and TRF may enter into investment agreements for a term longer than 5 years. It allows certain units in the 1977 Police Officers' and Firefighters' Pension and Disability Fund (1977 Fund) to buy back additional members' service. It would allow the Board to offer dental, vision and long-term health coverage. Last year's tax bill was the largest change for public pension plans in the last 10 years. It was an accumulation of items that the public pension funds' associations had been lobbying for more than 10 years. It is a beneficial bill for PERF's members because it allows for portability between a variety of funds with great

flexibility. However, all of this would create additional demand on the PERF staff in time and counseling. Senator Harrison has been asked to sponsor one additional change concerning the electronic transfer of funds which currently conflicted with some archaic language in the school corporation powers act and in cities and towns and local government powers act. This bill is sponsored by Representative Kromkowski and will be heard in the House Public Policy Committee.

- SB60. Deferred Retirement Option Plan (DROP) for police and firefighters. This establishes a deferred retirement option plan (DROP) for members of all police and firefighter pension funds. It provides that the DROP is available on January 1, 2003 and expires on December 31, 2007 and would offer the possibility to withdraw a partial lump sum. It is a very conservative DROP and presents little risk to participants. Participants are regarded as if on active service for purposes of line of duty benefits. In addition, it changes the line of duty death definition and introduces a clarification recommended by the 1977 Fund Advisory Committee. Development of these new options will require investment of PERF staff time and cost. Because of the way the 1977 Fund interacts with all the pension Boards, there will be a labor intensive education requirement by PERF to explain the mechanics to various municipal pension secretaries. PERF would probably be the provider of all educational material.
 - SB173. State police disability pension. SB0173 is applicable to State Police Officers only.
 - SB269. PERF vesting for county elected officials. This provides that a person serving as a county clerk, auditor, recorder, treasurer, sheriff, or coroner is vested in PERF after: (1) either eight years of service in that office; or (2) ten years of service based on a combination of service as an elected county official and as a fulltime employee in another covered position. The number of people affected by this was estimated to be minimal. Mr. Gery suggested that it might be a good idea to make the reduction to eight years applicable across the board, rather than to one small group only.
 - The Committee would be updated as the above bills progress through the approval procedures in the senate.
5. DATA CLEAN-UP PROJECT (NAVIGANT). At the request of the Board at their last meeting, PERF Staff had resumed discussions with Navigant on the contract to cleanup the remainder of PERF's data. The pilot project had encompassed PERF's top 20 employers. The scope of the project was to locate missing data, by completing demographic information and missing hire, termination and birth dates, etc. The IRIS system contained summary information that had been converted over to SIRIS by creating "blob" records. Navigant would be looking at these records and contacting employers to complete the missing data. The

project would commence 30 days following agreement of the contract and would take one year to complete. Navigant had presented the contract being negotiated 60 days ago. Last month they decided to review the scope of the contract to ensure that it was consistent with PERF's requirements. The contract is currently being 'massaged'.

6. 1977 FUND ADVISORY COMMITTEE. Mr. Gohmann advised that three Line-of-Duty Death claims would be heard at the next meeting on February 28, 2002. In 2000, the Advisory Committee had been given the authority to review all disability determinations made by locally administered pension funds to determine whether they were duty-related or not. This decision does not affect the amount of the benefit for these members, but does have tax consequences. The Advisory Committee made its first determination under this new authority at the last meeting when the case in question was denied. This created an additional administrative task in that the Advisory Committee had to review each local fund determination. Both the member and city involved in the case would have the right to appeal determinations of the Advisory Committee, which may at some stage necessitate engaging an Administrative Law Judge (ALJ).
6. BENEFITS ADMINISTRATION COMMITTEE MEETING. Ms. Turner advised that the Committee had met that morning and discussion had focused on the benefits distribution process. Mr. Scott had provided a processing update addressing refunds, retirements and new membership applications processing.
 - Temporary staff had been added and working to reduce the backlog in processing new member applications. The situation in the refund section had also improved. A graph was provided to show the number of retirement benefits now being processed within 60 days. This information would be provided on a monthly basis.
 - Telecommunications Project. Once the contract was signed, the hardware could be in place and operational within 30 days. In 90 days, the staff and software could be in place and training completed.
 - Internal Auditor. Interviews had been scheduled.
7. INVESTMENTS. The Investments Committee had met earlier that day. Items addressed included the following:
 - Presentation by 21st Century Fund. Mr. Miller advised that the 21st Century Fund sponsors basic research and is financed by the Build Indiana Fund. They help to attract matching grants to help sponsor research and technology that would ultimately be converted into commercial uses. Their work is pertinent to PERF in that as PERF moves forward with its objectives of investing in Indiana ventures, the efforts that come out of the 21st Century

Fund might provide a source of candidates for Indiana capital venture funding. Their sponsorship program involves a rigorous selection process.

- Alternative Investment Procedures. The latest version included amendments to the role of the Board and the Investment Committee. The Board will approve a list of the providers for special services. The Investment Committee would approve the use of these services as required for staff to complete due diligence.

MOTION duly made and carried to approve the alternative investment procedures, as drafted on February 8, 2002, and to incorporate them into the alternative investment policy and the PERF Investment Policy.

Proposed by: Steven Miller
Seconded by: Nancy Turner
Votes: 5 for, 0 against, 0 abstentions

Mr. Miller noted that the entire approach to alternative investing and private equity differed to that for marketable securities, stocks, and bonds, etc. As PERF moves forward, it was important to develop well-defined procedures. As a Board, it was important to define a process of due diligence to screen entities with which PERF does business.

- Equity Manager Search. Mercer produced a list of RFP respondents in the four categories (Small Cap Value, Small Cap Growth, Mid Cap Value and Mid Cap Growth). Semi-finalists had been identified and the Chief Investment Officer and Mercer would produce a list of finalists to be interviewed by the members of the Investment Committee (two or three from each category).
- Mr. Miller advised that he had met with Brandes in California when a variety of subjects had been addressed. A written report on his visit is available. He had also met with Western Asset Management to discuss their performance and portfolio.
- Quarterly Performance Reports.
 - ❑ Mercer Report.
 - Results for the Fourth Quarter had been slightly positive although there was consensus that this figure would be revised to negative growth. We are in a below average growth environment as well as in a recession. The Federal Reserve met and cut interest rates during the quarter. They met again in January and made no change. The significant reduction in short-term interest rates in an effort to bolster economy had at least paused for now.

- Domestic Equity Markets. Markets rebounded primarily in October and November. Markets were positive, growth outperformed value and Small Cap outperformed Large Cap during the quarter.
- Sector Performance for the Fourth Quarter. There were significant returns in technology, consumer durables and transportation sectors.
- Markets. Credit and mortgage-backed securities were the best areas for fixed income managers. Credit sectors performed well during the Fourth Quarter.
- Performance by Region and the International Markets. Emerging markets represented a strong area during the Fourth Quarter. Japan was the major market with a negative return – mainly due to currency during the quarter.
- Asset Allocation of Fund. The Fund is currently underweight in Mid Cap equity. A search is currently in process to bring the allocation to target.
- Allocation. The Fund was \$9.6 Billion slightly over-weighted in Fixed Income.
- Performance. The total fund was up by 6.8% for the quarter. There was mixed performance relative to benchmarks, but positive relative to the public fund universe that was up by 6.8% as well. The one-year performance was down by 1.2%. In a very down market, the Fund out-performed its benchmarks. The public fund universe was down 4.8%. Domestic equity portfolio was down 8.1% for the year. Performance was strong in the Small Cap equity allocation.
- Large Cap equity managers were generally right on top of their benchmarks, largely due to the large index allocation in that area. For a one-year period, Small Cap equity managers performed well. In the Fourth Quarter, Small Cap did not do quite as well as the Russell 2000. The International Equity portfolio was up 8.7% during the Fourth Quarter. Fixed income was fairly flat for the period.
- Managers. For the most part, within the Large Cap area, the managers tracked the benchmark during the quarter. Mr. Miller asked if it was the intention to replace existing Small Cap enhanced managers as a result of the Small Cap and Mid Cap searches. He was advised that some would probably be replaced.
- The TIPS portfolio was down by 1% for the Fourth Quarter. Black Rock was an extremely strong performer in the fixed income area for

the Fourth Quarter. For the remainder of the Fixed Income Allocations, the managers in the Fourth Quarter that had held Enron related securities or securities within that part of the market were hurt significantly.

- ASA - Allocation to various options. The Guaranteed Fund had the largest proportion of the money but in the remaining options the participants were heavily focused in the equity area.
 - Performance. Guaranteed Fund Performance showed an 8.3% return.
 - 1977 Fund Performance. BGI lagged a little but the one-year performance was right on track relative to the index. Although no managers were of particular concern right now, as the equity portion of PERF's review is completed, it could be a good option to review the fixed income managers. The review carried out last year by the Investment Committee had shown that the number of managers for Fixed Income was more than forecasted and this was an area which could be reduced at some point. The issue is scheduled for review later in 2002.
 - In 2000 and 2001, active managers outperformed passive strategies although this was very time period dependent.
 - Mr. Doermer asked for a condensed one-page summary of the information above. Ms. Braming would provide a summary showing the performance of a specific manager or sector of the Fund with the specific index that they are compared to against the consolidated results.
- Burnley Compliance Report. Mr. Boggs provided his report. Highlights were as follows:
- Investment Guidelines. All Investment Managers appeared to be following the investment styles for which they were hired.
 - Fixed Income Characteristics. There were no serious violations. Qualities were good. The three-year standard deviations are within limit with nothing seriously out of balance. Some securities were below investment grade.
 - Security Lending. The total was \$3.7 million. In future reports stocks and bonds will be broken out.
 - Brokerage and Trading. The year total was \$2,800,000.

- Proxy Voting. Proxy voting procedures are currently under review. The Institutional Shareholders Service (ISS) will be invited to give a presentation at the Board Meeting on March 15.
- Soft Dollars. Managers had been asked to report to us how they used soft dollars and for which services. Ms. Gerrick advised the issue would be presented later in the year when policies for commission recapture, directed brokerage and minority brokerage are presented for Board consideration.
- It was noted that PERF paid lower fees because a significant part of its assets were indexed and indexed managers typically have very low transaction costs. Ms. Ghilarducci considered that soft dollar policies were an issue of controversy, and it was important to monitor this. Mr. Miller considered that the whole subject matter of direct commissions and brokerage was something that required more Board level education. Ms. Gerrick will research this issue and come back with an overview on the subject.
- Approximately 55 – 60% of PERF's total equity exposure is indexed. The majority of the large cap equity is indexed. An indication of percentages of indexing in the total fund was requested in order to show how the indexed amount is reflected in the asset allocation made. This should be shown in subsequent reports.

8. AUDIT/BUDGET COMMITTEE REPORT. Mr. Doermer advised that the Audit/Budget Committee had met on January 31, 2002 in Muncie. Highlights of the meeting are as follow:

- In the year to end (6/30/01) \$19 million was spent on total administrative and investment expenses. Expenditure of \$27.2 million was anticipated in the current year for the same general categories, which represents a significant but necessary increase in spending driven by the Navigant data cleanup project and the Covansys projects for backfile conversion and IT services. In the current year forecast, \$12.6 million is projected for developing the SIRIS program. PERF's share is 7.5 million; the remainder is financed by TRF because it is a joint project.
- The PERF Staff at the end of Calendar Year December 31, 2000 comprised 41 persons excluding temporary employees. By June 30, 2002, there will be 75 employees.
- A listing of consulting firms and those with whom we have contracts for services including investment managers had been compiled. This indicated the general services provided and corresponding expenditure for the first six months of this year with a forecast to year-end June 30, 2002.

- Spending had been significant during the first half of the year. A large part of this figure was for the data cleanup project performed by Navigant. The Backfile conversion project represented a one-time service costing \$1.7 Million. Eclectic managed the old IRIS system although this cost should virtually disappear next year when the full changeover to the SIRIS system would be made. The on-going SIRIS costs will be in the region of \$1.2 Million related to the outsourcing of IT programming services to Covansys.
- PERF Technical Projects. A list of the principal vendors and their services was provided. This incorporated estimated completion dates for various projects.
- Guidelines for recommended budget practices had been provided.
- Budget Timeframe. Department managers have been asked to submit their budget input by March 2002. A consolidated budget will be submitted to the Board of Trustees for discussion in May. The Audit/Budget Committee will then formalize recommendations and submit this to the Board in June for final approval.
- Breakdown of the Budget by Cost Centers/Departments. A monthly report will be provided in FY 03 comparing actual expenses to the budget.
- The reforecast of the FY 02 budget. This will be addressed at the March Board meeting.
- Mr. Doermer commended the staff on the work done so far and noted that a very effective budgetary process was being adopted.

9. NEXT MEETING

The next meeting of the Board will be held on Friday, March 15, 2002 at 1.00 p.m.

10. ADJOURNMENT

There being no further business, the meeting was adjourned.